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CITATIONS

648369—45

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 1247

J. V. VANDENBERGE ET AL., TRANSFEREES OF TEXAS AUTO COMPANY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 31–42) is reported at 3 T. C. 321. The opinion of the Circuit Court of Appeals (R. 57–59) is reported at 147 F. 2d 167.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 12, 1945. (R. 60.) The petition for a writ of certiorari was filed on May 8, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the cost of property within the meaning of Section 113 (a) of the Revenue Act of 1938 and the Internal Revenue Code is limited to the consideration paid by the purchaser in acquiring the property.

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.
>
> (a) *Basis (Unadjusted) of Property.*— The basis of property shall be the cost of such property; except that—
>
> * * * * *
>
> (26 U. S. C., Sec. 113.)

The corresponding section of the Revenue Act of 1938, c. 289, 52 Stat. 447, is substantially the same as the above.

STATEMENT

In 1922 the Texas Auto Company, 45% of whose stock was then owned by Clark Pease, purchased certain improved real estate from the J. C. Blacknall Company. The property was deeded for a recited consideration of $10 "and other valuable consideration" and "subject to all existing indebtedness thereon." (R. 33.) The Blacknall Company was indebted on two notes aggregating $20,000, which were secured by liens on the property conveyed. These notes were subsequently paid by the Auto Company. (R.

33–34.) Blacknall and his associated companies were also indebted to the City National Bank of Corpus Christi, Texas, of which Pease was president and controlling stockholder, on six unsecured notes aggregating $24,567.16. It was agreed between Blacknall, his associated companies, Pease and the bank that this indebtedness would be released and discharged upon conveyance of the property here involved to the Auto Company. This discharge was effected, the six notes being delivered to Blacknall in 1924 without his giving further consideration. In its 1922 income tax return the bank charged off as worthless an indebtedness of approximately $25,000, including the six notes, against Blacknall and his companies, and the bank has failed to make any substantial recoveries on this indebtedness. (R. 34.)

The Auto Company ascribed, for depreciation purposes, a cost of $45,000 to the property acquired from J. C. Blacknall Company, allocating $20,000 to the land and $25,000 to the improvements. Depreciation on the building was claimed and allowed in the aggregate amount of $16,417.30 for the years 1923 to 1937, inclusive. In July, 1939, the Auto Company sold the property for $36,000. (R. 34–35.)

In determining deficiencies of the Auto Company's income and excess profits taxes for 1938 and 1939, the Commissioner of Internal Revenue allowed an original cost of only $20,000 for the property involved, based on the secured notes

which were paid by the Auto Company in discharging indebtedness on the property. The asserted additional cost of about $25,000, represented by the six unsecured notes surrendered by the bank, was disallowed. Employing this lower allowed cost as a basis, the Commissioner determined that a net gain of $27,111.11 resulted from the 1939 sale, or $10,000 in excess of that reported by the Auto Company; and also disallowed a claimed depreciation of $1,400 for the building in 1938. (R. 35.) The Tax Court sustained the Commissioner's determination (R. 36–39) and this decision was affirmed by the Circuit Court of Appeals (R. 57–59).

ARGUMENT

In holding that the basis of the property was limited to the $20,000 paid by the Auto Company in discharging the indebtedness thereon, and did not include the value of the unsecured notes surrendered to Blacknall by the bank, the court below rendered a decision which was correct and which does not call for further review.

The statute establishing the unadjusted basis of property for purposes of both depreciation and capital gain or loss provides that "the basis of property shall be the cost of such property." Section 113 (a), Internal Revenue Code and Revenue Act of 1938, *supra*. The Circuit Court construed this statute to mean that the cost of property is the price paid to acquire it. It then concluded that in

the present case "the only consideration paid by the purchaser was $20,000, and no other consideration passing anything of value moved to the seller from any one else." (R. 59.) This conclusion was predicated upon a finding by the Tax Court that the six notes surrendered to Blacknall by the bank were without value. The court below accepted this finding as conclusive, since it was based upon the action of the bank in charging off the indebtedness as worthless and the further fact that no recovery had been made on the notes prior to their surrender, and since there was no evidence to the contrary. Inasmuch as this finding as to value involved a factual determination, the court below properly refused to disturb it on review. *Elmhurst Cemetery Co.* v. *Commissioner*, 300 U. S. 37.

In view of the conclusively found fact that no consideration other than the $20,000 moved to Blacknall, the court below correctly ruled that this price constituted the cost basis of the property within the meaning of the statute. Moreover, it was unnecessary for the court to decide the question whether the value of the six notes surrendered by the bank should be included in the cost basis or whether cost as used in the statute is limited to cost to the taxpayer, for such a question would be meaningful only if the notes were of value. Hence to the extent that the grounds relied upon by petitioners for allowance of this writ are addressed to this question (Pet.

6), they are not responsive to the decision below. But even if this issue be considered as passed upon by the Circuit Court of Appeals, it is submitted that it was correctly decided.

Limitation of a taxpayer's basis to his own investment in property has been sanctioned by this Court and consistently recognized by other courts. See *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98; *Nashville Warehouse & El. Corp.* v. *Commissioner,* 105 F. 2d 883 (C. C. A. 6th); *Robinson* v. *Commissioner,* 97 F. 2d 552 (C. C. A. 9th); *Kell* v. *Commissioner,* 88 F. 2d 453 (C. C. A. 5th); *North American Coal Corp.* v. *Commissioner,* 28 B. T. A. 807; *cf. Friend* v. *Commissioner,* 119 F. 2d 959 (C. C. A. 7th), certiorari denied, 314 U S. 673. In the *Detroit Edison* case, prospective customers made payments to an electric company to defray estimated expenses of constructing facilities needed to serve customers. It was held that these contributions should be excluded from the company's basis for depreciation purposes. In sustaining a basis reflecting the company's net investment, which was less than the value of the property acquired, this Court stated (p. 102): "But we think the statutory provision that the 'basis of property shall be the cost of such property' (§ 113 (a)) normally means, and that in this case the Commissioner was justified in applying it to mean, cost to the taxpayer."

The rationale of *Arundel-Brooks Concrete Corp.* v. *Commissioner,* 129 F. 2d 762 (C. C. A.

4th), upon which petitioners place principal reliance (Br. 12–19), is that cost as used in the statute refers to total cost of the assets and not net cost to the taxpayer. But this rule, we submit, cannot be reconciled with the *Detroit Edison* holding, a conflict which was recognized by this Court in granting certiorari in the *Detroit Edison* case. The basic factual distinctions between the two cases are certainly not substantial enough to support petitioners' assertion that this Court has in effect affirmed the *Arundel-Brooks* rationale. (Br. 18.)

CONCLUSION

The decision below is correct and there is no conflict. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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